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No. 81-523

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1982

CONTAINER CORPORATION OF AMERICA,

Appellant,

v.

FRANCHISE TAX BOARD,

Appellee.

ON APPEAL FROM THE COURT
OF APPEAL OF THE STATE
OF CALIFORNIA, FOR THE
FIRST APPELLATE DISTRICT

APPELLEE'S BRIEF ON THE MERITS

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Vol. I of II

QUESTIONS PRESENTED:

The questions raised by the Arguments made in Appellant's Brief are:

1. Has appellant carried its burden of establishing on the record herein that due process clause of the United States Constitution prevents use of formula apportionment and requires refund of any amount of tax in issue because of claimed lack of a "unitary business" (App. Brief, Arg. II, pp. 40-49), or "distortion" and "extraterritorial taxation" (App. Brief, Arg. I(A,B) pp. 11-20.)

2. Has appellant carried its burden of establishing on the record herein that the commerce clause of the U.S. Constitution requires refund of any amount (and what amount of the tax in issue because of claimed "taxation of income also taxed by foreign countries"

(App. Brief, Arg. I(C) pp. 21-26), or claimed prevention of the federal government "speaking with one voice in regard to foreign policy" (App. Brief, Arg. I(D), pp. 27-36.)

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TABLE OF CONTENTS

	Pages
QUESTIONS PRESENTED	i - ii
STATEMENT OF THE CASE	1 - 38
A. FACTUAL DETERMINATIONS BY LOWER COURTS	2 - 3
B. FACTS CONTAINED IN THE COURT OF APPEAL DECISION SHOULD BE THE BASIS FOR THIS COURT'S ACTION	3 - 5
C. EVIDENCE PRESENTED AT TRIAL SUPPORTS THE FINDING OF UNITY	5 - 36
1. CCA's Subsidiary Structure	7 - 8
2. CCA's foreign Operations Staff	8 - 12
3. Technical Service Agreements Required CCA to Provide Broad Technical and Managerial Advice to the Foreign Subsidiaries	12 - 17
4. Formation of Subsidiaries	17 - 18
5. Continuous Personnel Coordination Exists	18 - 21

6.	Continuous Training of Subsidiary Personnel was in Fact, Provided By CCA	21 - 23
7.	Auditing and Financial Accounting Were Coordinated and Used to Assure that Foreign Subsidiaries Complied With CCA Policies	23 - 24
8.	Major Financial Assistance Was Provided Gratis by CCA to the Foreign Subsidiaries	24 - 25
9.	CCA Furnished Directly to and Obtained Machinery and Equipment for Its Foreign Subsidiaries	25 - 27
10.	CCA Provided Substantial Paperboard and Raw Materials for Its Subsidiaries and Assisted in Developing Local Sources	27 - 29
11.	CCA Provided Assistance to Its Foreign Subsidiaries in Sales of Packaging Products	29 - 31
12.	Subsidiaries Used CCA's Insurance Brokers	31

13. CCA Represents Its Foreign Subsidiaries to Be Part of Its Unitary Business to Its Stockholders and the Public 31 - 32

14. CCA's Separate Accounting Does Not Reflect Its Large Contributions to Its Foreign Subsidiaries 32 - 35

D. ADDITIONAL FACTS SHOW NO DENIAL OF DUE PROCESS 36 - 38

E. CCA SETS FORTH NO FACTS SUGGESTING VIOLATION OF THE COMMERCE CLAUSE IN ITS STATE OF THE CASE 38

SUMMARY OF ARGUMENT 39 - 44

ARGUMENT

I CCA HAS THE BURDEN OF ESTABLISHING UNDER CALIFORNIA PROCEDURAL LAW BY CLEAR AND CONVINCING EVIDENCE THAT IT HAS BEEN DEPRIVED OF CONSTITUTIONAL RIGHTS WHICH HAS RESULTED IN OVERPAYMENT OF A SPECIFIC AMOUNT OF TAX 45 - 56

A. The Unitary Question Should Be Considered On the Basis of the Facts Contained in the Court of Appeal Opinion 49 - 51

B.	If the Record is Reviewed for Evidence of Lack of Unity, All Inadequacies, Ambiguities and Inferences Must Be Resolved Against the Taxpayer-Appellant and All Presumption in Favor of Unity Applied	51 - 56
II	CCA'S FOREIGN SUBSIDIARIES ARE PART OF ITS UNITARY BUSINESS UNDER TESTS APPLIED BY THIS COURT	57 - 89
A.	The Due Process Requirements of Unity Should Be No Greater Than California's Contribution Test	60 - 61
B.	Woolworth and ASARCO Reinforce the Rule That an Activity is Part of a Unitary Business Unless it is a Distinct and Discrete Business Which Does Not Benefit the Whole	61 - 68
C.	CCA's Subsidiaries Are Not Discrete Businesses. They Are Part of Its Unitary Enterprise	68 - 83
D.	Intercompany Product Flow Is Not a Prerequisite to the Existence of a Unitary Business	83 - 87

E. Income of Foreign Subsidiaries Which are Part of a Unitary Business May Be Combined Without Violating Due Process 87 - 89

III CCA HAS NOT SHOWN DISTORTION BY THE FORMULA 91 - 108

A. Separate Accounting Data Does Not Impeach the Formula 91 - 99

B. Differing Wage Rates and Rates of Return Do Not Impeach the Formula 99 - 108

IV THE COMMERCE CLAUSE DOES NOT REQUIRE REVERSAL 109 - 131

A. Here No Tax is Imposed On Foreign Commerce 109 - 114

B. CCA has Not Proven Unconstitutional Double Taxation Here 114 - 121

C. CCA has Not Proven Interference In Violation of the Commerce Clause With Foreign Relations 121 - 131

V AMICI SUPPORTING APPELLANT SHOW NO UNCONSTITUTIONALITY 132 - 138

CONCLUSION 138 - 140

APPENDIX

Appendix A:

Management Theory:
Selected Excerpts A1 - A15

Administrative Organization
Prentice-Hall, Inc.
Englewood Cliffs, N.J.
1960, John Pfiffner and
Frank Sherwood A2 - A11

Management: Tasks,
Responsibilities, Practices
Harper & Row, New York 1974
Peter F. Drucker A11 - A15

Appendix B:

Exhibit D to Stipulation
of Facts --
Container Corporation of
America Former CCA
Employees Working for
Foreign Subsidiaries A16 - A19

Appendix C:

Source Variations Computed
on the Basis of Taxable
Income A20 - A24

Appendix D:

Caterpillar Tractor Co.,
et al v. Illinois Dept
of Revenue, et al and
Coca-Cola Co., et al
Intervenor, Illinois
Supreme Court No. 52818, 52828,
52903 (Argument I thereof) A25 - A52

Appendix E:

Excerpt from International Division of the Income Tax Base of Multinational Enterprise, Publ. Multistate Tax Commission, 1981, Geoffry John Harley A53 - A55

* * * * *

TABLE OF AUTHORITIES

	Pages
CASES	
ASARCO, Inc. v. Idaho State Tax Commission 50 U.S.L. Week 4952, ___U.S.___	62,63,67
Bass, Ratcliff & Gretton Ltd. v. Tax Commission (1924) 266 U.S. 271	83,86,95 111
Bd. of Education v. Jack M. (1977) 19 Cal.3d 691	52
Butler Bros. v. McColgan (1941) 17 Cal.2d 664, affd. (1942) 315 U.S. 501	19,77,84 95,96
California Liquor Dealer's Assn. v. Midcal Aluminum (1980) 445 U.S. 111	49
Denham v. Superior Ct. (1970) 2 Cal.3d 557	52
Edison California Stores v. McColgan (1947) 30 Cal.2d 472	58
El Dorado Oil Works v. McColgan (1950) 34 Cal.2d 731	46,53
Exxon Corp. v. Wisconsin Dept of Revenue (1980) 90 Wis.2d 700, affd. 447 U.S. 207	58,77,81,85 95,89,91-93

F.W. Woolworth v. Taxation and Rev. Dept of New Mexico 50 U.S.L.Week 4957, ___U.S.___ 62,64-65 66,67

Flying Tiger Line v. St. Bd. of Equalization (1958) 157 Cal.App.2d 85 45

General Motors Corp. v. Washington (1964) 377 U.S. 436 54

Hall v. Franchise Tax Board (1966) 244 Cal.App.2d 843 45

Honolulu Oil Co. v. Franchise Tax Board (1963) 60 Cal.2d 417 59,86

Japan Line Ltd, v. County of Los Angeles (1979) 441 U.S. 434 109,112,113 114,115

John Deere Plow Co. of Moline v. Franchise Tax Board (1951) 38 Cal.2d 214 app. dism. 343 U.S. 939 100

Mae See v. North American Acc. Ins. Co. (1923) 190 Cal. 421 52

McIntyre v. Doe & Roe (1954) 125 Cal.App.2d 285 52

Michelin Tire Corp. v. W. L. Wages (1976) 433 U.S. 276 130

Mobil Oil Corp. v. Comm'r of Taxes (1980) 445 U.S. 425	61,85,87,88 113-114, 116 120-121,122-123
Norfolk & Western RY Co. v. No. Carolina (1936) 297 U.S. 682	46,53,103
Norton Co. v. Dept of Rev. State of Illinois (1951) 340 U.S. 534	54
Pacific Fruit Express Co. v. McColgan (1944) 67 Cal.App.2d 93	46
Shell Petroleum N.V. v. Mary Ann Graves, et al No. C814302 (N.D.Cal)	134,136
Sullivan v. United States (1969) 395 U.S. 169	124
Sumitomo Shaji America, Inc. v. Avagliano (Jun 15, 1982) 50 U.S.L.Week 4643	128,129
Superior Oil Co. v. Franchise Tax Board (1963) 60 Cal.2d 406	59,86
Time, Inc. v. Firestone (1976) 424 U.S. 448	49
Underwood Typewriter Co. v. Chamberlain (1920) 254 U.S. 113	83,111
Washington Rev. Dept. v. Stevedoring Assn. (1978) 435 U.S. 734	130,131

Wisconsin v. J.C. Penney, Co.
(1940) 311 U.S. 435 130,131

CONSTITUTIONS

U.S. Constitution, Art 1,
§ 8, cl. 3 121

STATUTES

California Evidence Code
§§ 500, 550 45

Internal Revenue Code
§§ 951-964 98

RULES OF COURT

U.S. Supreme Court Rules
rule 34.1(g) 48

Calif. Rules of Court,
rule 29, ¶ b 50

ARTICLES/REPORTS

Allocation of Income in State
Taxation, G. Altman & F. Keesling
Commerce Clearing House, 2d ed 1950 11

International Division of the Income
Tax Base of Multinational Enterprise,
Geoffry John Harley, Multistate Tax
Comm, 1981 60

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Allocation Under Section 482
of the Internal Revenue Code,
89 Harvard L.Rev 1202 (1976) 96

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Report to the Chairman, House Committee on Ways and Means by the Comptroller General, Sept. 30, 1981 94-95

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Convention between the United States and the Soviet Union for the Avoidance of Double Taxation 125-126

United Kingdom Convention for Avoidance of Double Taxation, Reservation of Art. 9(4) 122,133

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ON APPEAL FROM THE COURT OF APPEAL
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APPELLEE'S BRIEF ON THE MERITS

STATEMENT OF THE CASE

Appellant's statement of the case omits material facts, misstates others, and ignores the factual determinations made by all lower courts which agreed that CCA's foreign subsidiaries were part of

its unitary enterprise. It should be disregarded; this case should be decided upon the facts set forth hereinafter.

A. FACTUAL DETERMINATIONS BY LOWER COURTS

Both California's trial court and Court of Appeal found on the evidence in the record that plaintiff's foreign subsidiaries were part of its unitary business. CCA (plaintiff and appellant) did not request findings of fact from the trial court; accordingly, under California law and procedure, all facts and inferences in support of the judgment are deemed to have been made by the trial court. The evidence before the trial court on the question of unity consisted of stipulated facts (primarily J. A. pp. 5-82) and exhibits offered separately in evidence (including technical service agreements,

. . . .

. . . .

annual reports, etc.) numbered A through K.[1]

B. FACTS CONTAINED IN THE COURT OF APPEAL DECISION SHOULD BE THE BASIS FOR THIS COURT'S ACTION

The California Court of Appeal recited in its opinion the facts which it felt were material thereto. Under appropriate appellate procedures, this case should be resolved on the basis of those facts, rather than by an independent review by this Court of the evidence in

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1. At trial there was also testimony offered both orally (J.A. pp. 118-223) and by stipulation (J.A. pp. 83-117) pertaining primarily to arguments of distortion and double taxation. Appellant's Statement of the Case refers to none of these facts. It is required by Rule 34.1(g) to include in its Statement of the Case everything material to consideration of the questions presented. Appellant's failure to do so should preclude consideration thereof on this appeal. Accordingly, appellee will not discuss such facts in its statement of the case.

the record.[2/]

The facts considered to be material by the California Court of Appeal are contained in its opinion (Juris. Stmt., Appen. A; see also 117 Cal.App.3d 988; 73 Cal.Rptr. 121). These facts are

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2. California Rules of Court, rule 29 provides in part:

> (b) On petition for hearing the Supreme Court will not examine the record for error unless the petition shows that substantial issues of. . . fact were incorrectly stated . . . in the opinion of the Court of Appeal and that such issues were . . . set forth in a petition for rehearing in the Court of Appeal."

While Appellee contends in a footnote to its statement of the case (App. Brief (hereinafter AB) p. 2, fn. 1), that the California Court of Appeal inaccurately stated three facts, it fails to show that it pointed out to any such alleged errors in a petition for rehearing. Absent contesting the accuracy of the factual statement by the Court of Appeal on a Petition for Rehearing, the California Supreme Court was bound by the factual statements of the Court of Appeal, and this Court on an appeal from the final state decision (by the Calif. Supreme Court in denying a hearing), should be similarly bound.

incorporated by this reference. (See J.S. pp. A-1 - A-26.)

C. EVIDENCE PRESENTED AT TRIAL SUPPORTS THE FINDING OF UNITY

A summary of the evidence presented at trial court which establishes that plaintiff's foreign subsidiaries are part of its unitary business includes the following:

This action involves a suit for refund of franchise taxes paid under the California Bank and Corporation Tax Law based upon appellant's activities during 1963, 1964 and 1965. (J.A. p. 6, ¶ 8.) The stipulated facts unless otherwise noted, pertain to the years 1963-65. (J.A. p. 6, ¶ 6.)

Container Corporation of America (CCA) was a Delaware corporation with principal offices in Illinois. (J.A. p. 6-7, ¶ 9.) CCA is an "integrated producer" of paperback packaging, producing paperboard

and manufacturing paperboard packaging products, especially corrugated and solid fiber shipping containers. (J.A. pp. 17-18.) ¶¶ 29, 30.) CCA operated throughout the United States and also made sales to other countries through plant salesmen which were based in or traveled to such countries, primarily Canada and Puerto Rico. (J.A. pp. 18-19, ¶¶ 31, 32.) CCA is decentralized, organized with a single regional Vice President responsible for all phases of operation in his region. (J.A. pp. 13-14, ¶ 24.)

CCA had approximately $30 million in sales, $10 million in payroll and $15 million in property in California during each of the years on appeal. (See J.A.:Exhibits [hereinafter J.A.:Ex] pp. 2, 4, 6 "CCA California Factors.") CCA treated, and does not now contend otherwise, that its own operations were a

unitary business; it objects, however, to including any of its foreign subsidiaries in its unitary business.

1. CCA's Subsidiary Structure

CCA commenced operations through subsidiaries by forming its own subsidiaries in Colombia (1944), Venezuela (1953), Germany (1955) and Italy (1958), and by acquiring an existing company in Mexico (1944) and in Holland (1958). All these subsidiaries were engaged in some aspect of the same paperboard/packaging business which CCA engages in. (J.A. pp. 14-15,¶ 25.) CCA also had a Panama holding company, and an inactive Austrian subsidiary. (Ibid.) "Carton Internacional, S.A." the holding company had no property, no payroll and no sales, but nonetheless was assigned about $1.5 million of net income annually under CCA's separate accounting procedures. (J.A.Ex pp. 3,5.)

Most subsidiaries were wholly owned by CCA. (J.A. pp. 14-15.) Minority interests were created in some to obtain more favorable business considerations and minimize antagonism of foreign countries toward United States owned subsidiaries. (J.A. pp. 14-16, ¶¶ 25, 27.) When several subsidiaries existed within a country, they operated as an integrated unit with one dominant subsidiary coordinating the operations of all the subsidiaries based within that country. (J.A. pp. 31-32, ¶ 63.)

2. CCA's Foreign Operations Staff

CCA maintained a "foreign operations staff" consisting of a "Senior Vice President of Overseas Operations", a Vice President of European Operations," a Vice President of Latin American Operations," a controller, and an attorney. These three individuals had other duties and responsibilities. (J.A. pp. 65-67, ¶ 126-130.)

Mr. Green, the Senior Vice President of Overseas Operations, made decisions regarding the overall overseas operations and visited each country where CCA had subsidiaries once or twice a year." (J.A. pp. 65, ¶¶ 126-127.) His primary functions were to "oversee CCA's foreign subsidiaries and communicate requirements for compliance with CCA's standards for professionalism, profitability and ethical practices." (Id., at p. 66.)

In addition Mr. Green (as general counsel) and another attorney on CCA's staff handled CCA's international legal affairs. (J.A. p. 65.) Mr. Ulvaeus, CCA's "Vice President of European Operations," earlier worked for CCA in sales, then for a European subsidiary before being promoted to this position. He had "responsibility for all European subsidiaries which included eighteen plants in three countries," and was simultaneously

the chief operating officer of one of the European subsidiaries. (J.A. p. 66, ¶ 128.)

Earl Kauffman worked for CCA from 1933 to 1954 when he "transferred to Carton de Venezuela"; he became CCA's Vice President of Latin American Operations" in 1963. He had "responsibility for all Latin American operations which included 25 plants in three countries." (J.A. p. 66.) Both Ulvaeus and Kauffman were on CCA's payroll and were also paid by foreign subsidiaries to the extent that they performed functions for them. They acted as "steward for CCA's foreign interests, and liaison between the parent and subsidiaries in their respective localities." They "were involved with major problems and long-range decisions." Each reported directly to Mr. Green, and the foreign operations staff "presented studies and make recommendations with

respect to foreign activities to CCA's management committee and board of directors." (Capital appropriations, including acquisitions of new equipment, were considered major policy matters which had to be reviewed and approved by CCA management in Chicago.) (J.A. pp. 39-40, ¶ 74.)

The Foreign Operations Staff spoke for CCA in dealing with its subsidiaries. Through them CCA held local management strictly responsible for its performance. Generally, day-to-day business decisions were left in all cases by CCA to its local managers, believing it impossible to impose such responsibility on managers without giving them commensurate authority in order to preserve morale and long-term performance. (J.A. pp. 67-68, ¶ 130.) (This appears to be the identical decentralized management approach followed

in operating its concededly unitary, but similarly decentralized United States operations.[3/]

The vice chairman of CCA's board of directors, Mr. Spachner, was involved together with Mr. Paepcke, former President of CCA, in the early planning and administration of foreign operations. (J.A. p. 68, ¶ 131.)

3. Technical Service Agreements Required CCA to Provide Broad Technical and Managerial Advice to the Foreign Subsidiaries

CCA had formal technical service agreements with its subsidiaries in Mexico, Netherlands, and Germany. (J.A. p. 74, ¶ 144; J.A.:Ex pp. 9-33 - Exh. F.) The agreements require CCA to provide to the subsidiaries all assistance required by

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3. See Appendix A for a discussion of decentralization as a management philosophy.

the subsidiary, whether technical or managerial, industrial or commercial or otherwise, related to their mutual paperboard/packaging business.[4/] There were no technical service agreements in

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4. The agreements with the European subsidiaries generally provided as follows:

> The subsidiary engages in the "same industries" as CCA and wishes to "partake of the experiences accumulated by CCA" "[i]n order to develop its business. . . ." (J.A.:Ex p. 9.) CCA agrees
>
> ". . .to provide advice and consultation . . . concerning manufacturing techniques, engineering, design, architecture, insurance and cost accounting . . . to render any other assistance which the subsidiary may require in connection with any aspect of its industrial or commercial operations."
>
> ". . . CCA will furnish [subsidiary] with all technical bulletins and other material that [CCA] uses in the United States and that [subsidiary] may require from time to time. [CCA] will undertake to answer [subsidiary's] requests for assistance in these areas by correspondence as explicit as [subsidiary] may require,

Colombia and Venezuela because blanket agreements are not allowed by these countries; however, CCA did perform identical services

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fn. 4 (cont'd)

> and besides, at the request of [subsidiary] it shall send qualified personnel to Germany or train employees of [subsidiary]."
>
> "[Subsidiary] shall not have the right to pass the informations received from [CCA] on to third parties, but only to use it for its own ends." (J.A.:Ex pp. 9-10.)

CCA's technical service agreements with Mexico specifically provide as follows:

That CCA has within its industrial, administrative and commercial personnel, the experts necessary to furnish technical assistance and is willing to do so,

> "For the efficient operation of the above-mentioned industrial plants, [subsidiary] requires the technical assistance which it has requested from [CCA] as a consequence of their close commercial relationship. . . ." (J.A.:Ex pp. 13-14.)

CCA binds itself to render to the subsidiary technical assistance for their efficient operation of its present and future paperboard/container activities;

for these subsidiaries. (J.A. p. 74, ¶ 144.)

The "fair market value of many of the services cannot be ascertained,"

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fn. 4 (cont'd)

and agrees to furnish

> ". . . technical assistance as far as concerns the purchase of machinery and raw materials, the supervision of production methods and and the improvement of same in accordance with CCA's technical progress, the information of such raw material or finished products markets as may be of interest to it, as well as any other assistance which it may require in connection with any aspect of its industrial or commercial operations."
>
> [including]
>
> ". . . information, market quotations, sources of supply, industrial methods, all this by writing and as explicit as [subsidiary] may require, and besides, at the request of [subsidiary] it shall send to Mexico all the technicians or specialized personnel working under the services of CCA which [subsidiary] may require from time to time." (J.A.:Ex p. 14.)

All such information shall be considered confidential and subsidiary may not pass it on to other parties, but only use it for its own ends. (J.A.:Ex p. 15.)

therefore, charges were often computed on the basis of an apportionment of overhead of the relevant staff department (J.A. p. 75), (or under the technical service agreements as a percentage of trade sales or a fixed fee.) (See J.A.Ex pp. 11, 21.) Some of these charges were unrecoverable because of restrictions on payments to foreign affiliates and therefore, consisted merely of book entries. (J.A. pp. 74-75, ¶ 144.)

CCA provided market research assistance under the technical services agreement. (J.A. p. 33.) CCA's design laboratory did work for Mexican subsidiaries, and a "sophisticated design and market research facility" operated by Europa Carton provided services to all European subsidiaries. (J.A. p. 34.) CCA provided sample packages to its subsidiaries and assistance to subsidiaries in establishing design laboratories or expanding functions

of existing facilities. (J.A. pp. 34-35.) CCA provided suggestions as to the use of market research techniques and regarding "general problem solving procedures." (J.A. p. 35.) Generally, such assistance was given upon request.

4. Formation of Subsidiaries

When CCA formed its foreign subsidiaries it trained local personnel to assume major production responsibilities; key individuals were sent to the United States to study manufacturing practices in CCA plants, and CCA employees were sent as a complement to local personnel for the first few years, in addition to CCA's initial involvement with technology and personnel training, it also supplied the necessary equipment and a portion of raw material requirements until they could be locally developed. (J.A. p. 42, ¶ 79, discussing Colombia.) CCA formed its own subsidiaries

in all of the countries in which it had operating subsidiaries, except the Netherlands.

5. Continuous Personnel Coordination Exists

In addition to the vice presidents of CCA located in Europe and Latin America (to supervise and advise the foreign subsidiaries), other management personnel overlap and coordination existed between CCA and its foreign subsidiaries. Officers of CCA appear to have been both on the board of directors of each of the foreign subsidiaries, and served as officers for a number of the subsidiaries. (Exh. E to Stip. of Fact, in Record (hereafter "Ex.")

More importantly, CCA provided assistance to the foreign subsidiaries in finding employees for them with specific qualifications which were not available in the foreign countries. (J.A. p. 62, ¶ 120.) These people were first sought from within CCA.

Between 1958 and 1963, nineteen key management and supervisory personnel were so transferred. (Ex. D - Appen. B hereto.) An example of transfer of CCA management to a subsidiary is Russell Wilson who worked his way to General Supervisor in CCA, thereafter transferred to Venezuela in 1962, working in production and general management until 1967 when he became director of Venezuela's marketing operation. (J.A. p. 50, ¶ 94.) Another example was the transfer in 1961 of Frank Angeles, a designer in CCA's design laboratory to the Mexican subsidiary as "Art Director", which led to the creation of the subsidiary's design and market research center. (J.A. pp. 54-55, ¶ 106.)

In addition, general managers of divisions and a divisional director of manufacturing in Venezuela transferred from CCA in the early 1950's. (Ibid.) There were additional CCA employees who

transferred to foreign subsidiaries (ibid); CCA does not know whether the list (Ex. D) is complete or there were even more. (J.A. p. 62, ¶ 120.)

These employees wish to retain retirement and other employment benefits of CCA while working at the foreign subsidiaries. (J.A. p. 64-65, ¶ 124(c).) These transferees remained on CCA's payroll and retained all benefits of employment with CCA (except for a common stock bonus plan). Seven such employees were granted options under CCA's stock plan of 1956, indicating that they were considered to be key and important employees of CCA itself. (J.A. p. 65, ¶ 124(d).)

CCA's accounting department maintained the foreign employees on CCA's payroll, and was reimbursed for its services in payroll costs, but there is no showing that costs to CCA of options granted under

the stock plan or retirement or other benefits were not absorbed by CCA. (J.A. p. 65, ¶ 125.) Nor is there any suggestion that CCA did not absorb the costs of its "foreign operations staff" discussed above, or the unmentioned secretarial, accounting and clerical personnel who necessarily assisted the foreign operations vice presidents, attorneys and controller who made up the foreign operations staff. (See J.A. pp. 65-67.)

6. Continuous Training of Subsidiary Personnel was in Fact, Provided by CCA

After the initial extensive training provided during the formative years, CCA continued to be available at all times to provide additional training as needed to its foreign subsidiaries. Employees of (1 to 3 at a time) CCA's foreign subsidiaries made an average of 10 to 12 visits per year to CCA for

periods from two to six weeks each, "to familiarize themselves with the methods of operation of CCA." These visits were primarily by employees "in control functions" and occasionally plant managers. (J.A. p. 69, ¶ 132.)

In addition to transferring employees directly from CCA to foreign subsidiaries, Americans (most in management positions) who were hired by CCA to become (or otherwise became) employees of CCA's foreign subsidiaries, were also permitted to be placed on CCA's payroll. (See Ex. D.)

The frequency with which CCA technical employees visited foreign subsidiaries, and the nature of the activities and assistance given on such visits does not appear to be reflected in the record, accordingly, CCA has failed to carry its burden of showing that no substantial technical service and assistance was

provided by it under the technical service agreements and otherwise.

7. Auditing and Financial Accounting were Coordinated and Used to Assure that Foreign Subsidiaries Complied With CCA Policies

Monthly financial statements, occasional local plant financial reports and detailed annual financial statements were furnished to CCA from foreign subsidiaries. (J.A. p. 71, ¶ 135.) Also long-range three-year budget forecasts of capital projects were submitted by the subsidiaries to CCA and reviewed annually. Capital projects for each year were reviewed on a quarterly basis by Container's management committee and board of directors. When foreign subsidiaries borrowed funds on their own, there was some review by CCA management. (J.A. p. 70, ¶ 134.)

The same certified public accounting firm audited CCA and all subsid-

iaries, except Holland and Germany. (J.A. p. 72 ¶ 138.) Although accounting procedures and methods were not standarized, "CCA worked toward achieving the most efficient systems and procedures possible." (J.A. p. 72, ¶ 139.) Financial statements and information submitted by the foreign subsidiaries were adequate to determine the subsidiaries' condition, as otherwise CCA "would have been forced to take a more active role." (J.A. p. 72, ¶ 137.)

8. Major Financial Assistance Was Provided Gratis by CCA to the Foreign Subsidiaries

In addition to the substantial equity contributed by CCA, it also made substantial loans directly to its foreign subsidiaries[5/] and guaranteed a substantial portion of loans by third parties to the

---

5. $4,000,000 of long-term debt and $3,000,000 of short-term in 1963 and 1964. (J.A. pp. 69-70,¶176.)

foreign subsidiaries.[6] (J.A. pp. 69-70, ¶ 173.) Through these means CCA was directly involved in over one-half of the foreign subsidiary financing.

CCA has not established that it received any consideration for its guarantees or what rate of interest it was paid on its direct loans.[7]

9. CCA Furnished Directly to and Obtained Machinery and Equipment for its Foreign Subsidiaries

Normally, whenever CCA upgraded its American processes, it would initially

---

6. Guarantees covered approximately one-third of such loans, or between $2.8 million and $3.7 million. (J.A. pp. 69-70, ¶ 173.)

7. An examination of the federal Form 2952 (Ex. J) discloses that CCA received total interest payments from foreign subsidiaries of approximately $19,900 in 1963, $95,000 in 1964 and $59,500 in 1965 on outstanding balance of $7,704,987, $7,155,714 and $3,223,371 respectively. (J.A. p. 69, ¶ 133.) (A return of .003, .013 and .018 respectively.)

attempt to transfer its machinery or equipment which was being replaced to a subsidiary. If a subsidiary could use the machinery or equipment, the subsidiary normally paid CCA book value (cost minus depreciation) plus the costs of preparation and shipping. (J.A. pp. 76-77, ¶ 147.)[8/]

CCA's purchasing department also purchased (from outside sources) approximately 90% of the equipment obtained by the Latin American subsidiaries, and 10% of that going to Europe. CCA so purchased approximately five to seven million dollars' worth of machinery and equipment per year for subsidiaries. CCA's purchasing department was paid a fee which was

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8. Even at depreciated book value CCA's Mexican subsidiaries purchased over $20,000 and its Colombian subsidiaries, over $40,000 of used equipment in 1964. The amounts of such purchases in 1963 are not available, and thus must be presumed to be substantial since CCA carries the burden of proving that they were not. (J.A.:Ex p. 8.)

"somewhat" less than what independent assistance in obtaining this (mostly American) machinery and equipment would have cost the foreign subsidiaries. (J.A. pp. 7, ¶ 148.)

10. CCA Provided Substantial Paperboard and Raw Materials for its Subsidiaries and Assisted in Developing Local Sources

Because of the bulk, weight and transportation costs of raw materials, paperboard and products of the container industry, use of local raw material sources is required for economic, efficient manufacturing wherever possible. Thus, the furnishing of even small amounts of raw materials or paperboard from the United States to manufacturing plants in Europe or Latin America would not have occurred unless it had been important to the function of a foreign subsidiary to incur the substantial transportation costs.

The amount of direct sales by CCA to its foreign subsidiaries totalled an average of over $1 million per year. (J.A.:Ex pp. 2, 4, 6; also J.A. p. 73, ¶ 141.) In addition to furnishing its own product to its foreign subsidiaries, CCA purchased paperboard from third parties to be forwarded to its foreign subsidiaries. The extent of such assistance is unknown, but for the three years subsequent to this period, the amounts averaged about six million dollars per year. (J.A. p. 74, ¶ 143.)[9/]

In addition, CCA, its Colombian subsidiary, and the Colombian government, worked together in a joint venture to develop a special pulping process

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9. J.A.:Ex, Exhibit A-8 sets forth the amount of such purchases as a percentage of cost of goods sold (COGS). Since COGS includes labor and other costs, the percentages computed significantly understated the percentage of purchased goods acquired from, or through, CCA.

(J.A. p. 81, ¶ 158) to enable the Colombian subsidiaries to use local hardwoods rather than being dependent upon the more expensive imported wood pulp. (See J.A. pp. 44-45, ¶ 84.)

11. CCA Provided Assistance to Its Foreign Subsidiaries in Sales of Packaging Products

The end products which CCA and its subsidiaries manufacture, are not sold by them to the general public, but to businesses which have products needing containers or packages. CCA has not established that advertising[10] or sales

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10. In Europe no advertising was done in some years when advertising was done, "programs were very modest." (J.A. p. 59, ¶ 117, 118.) Mexico did very little advertising. (J.A. p. 55, ¶ 107) There is no mention of any advertising in Colombia, where CCA's subsidiaries had very little competition. (J.A. p. 47, ¶ 88.) In Venezuela an unknown amount of advertising was done under "marketing" as a staff function of the manufacturing operation. (J.A. p. 50, ¶ 93.) In Venezuela a director of marketing, division general manager and at least ten other supervisors and managers were transferred from, and on the payroll of CCA. (Ex. D - Appen. B hereto.)

departments are significant (let alone important or essential) to the efficient operation of business. The foreign subsidiaries made sales in their countries to other United States companies such as Colgate, Proctor and Gamble, Kleenex, Vicery, Oster, Pepsodent, Johnnie Walker, or to their foreign subsidiaries. (J.A. p. 32, ¶ 64.) CCA uniformly recommended its foreign subsidiaries to United States customers who inquired of CCA about obtaining packaging in foreign countries. (J.A. p. 33.) CCA assisted in the negotiation of at least one contract for a foreign subsidiary. (Ibid.) This was for production of bannana boxes, a product which (together with a multi-wall bag), accounted for 15% of the Colombian gross

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fn. 10 (cont'd)

The packaging products sold in Latin America were more basic; rigorous competition did not exist as in the United States. (J.A. p. 47, 50, 54, 37.)

sales. CCA has not established that similar assistance was not provided to other foreign subsidiaries, or that any payment was received by CCA for such negotiation assistance, or the referral of customers from the United States.

12. Subsidiaries Used CCA's Insurance Brokers

CCA and its Colombian and Venezuelan subsidiaries obtained insurance through the same primary broker; the Mexican subsidiaries obtained some insurance from one of CCA's brokers, and since 1967, all subsidiaries have used the same insurance agent as CCA. (J.A. p. 78, ¶ 149.)

13. CCA Represents its Foreign Subsidiaries to be Part of its Unitary Business to its Stockholders and the Public

CCA's annual reports clearly show that it considered its entire worldwide operations, including the foreign subsidiaries here in issue, to be part of a

single organization and operation. In its representations of the nature of its business to the public it did not publicly hold any of the foreign subsidiaries out to be "separate or discrete" business which were not integrated into its own paperboard and packaging operations throughout the world. (See Exh. I, see also Speech by CCA's President - Exh. H.)

14. CCA's Separate Accounting Does Not Reflect its Large Contributions to its Foreign Subsidiaries

The fair market value of many of the services provided by CCA to its foreign subsidiaries "cannot be ascertained." (J.A. p. 75, ¶ 144), and CCA has made no effort to show that the payments in any way approached the benefit to the subsidiaries.

CCA's separate accounting procedures simply do not accurately reflect the substantial contributions by it to its foreign subsidiaries which substantially

enhanced their profit on their separate books, but which were in fact due to assistance provided by CCA. These contributions include the following:

(1) Over half of the loans to the subsidiaries were made directly or guaranteed by CCA, with only limited interest payments on the lease and no payment for the guarantees. (See pp. 24-25, supra.)

(2) CCA sold its used equipment at book, not fair market, value to the subsidiary, and obtained equipment for subsidiaries without charging "arms length" brokerage fees.

(3) CCA employed, at its own expense, an international department which included a senior vice president, two vice presidents, an attorney and controller (undoubtedly together with substantial support staff), to oversee and advise the foreign subsidiaries.

(4) Other CCA officers and staff spent substantial time and expense in reviewing capital addition proposals by the foreign subsidiaries and expansion and development plans in various foreign countries. Experienced personnel were transferred by CCA to subsidiaries' key management positions when the subsidiaries were unable to obtain them locally without payment except salary reimbursement.[11/]

(5) There is no evidence that CCA received remuneration for its investment in the joint venture designed to develop the hardwood pulping process for the benefit of its Colombian subsidiaries.

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11. The success of the foreign subsidiaries, particularly during formation, without these key personnel is doubtful. The enormous benefit to the subsidiaries of such transfers can hardly be measured by the salaries paid by the subsidiaries. (Such persons retained other non-salary CCA benefits; there is no evidence that CCA was reimbursed for these other benefits, including stock options.)

(6) There is no evidence that CCA received any remuneration under its separate accounting for its referral of customers to its foreign subsidiaries or the negotiation of the bannana box contract or other contracts.

(7) The mere fact that the individual foreign subsidiaries were part of a world-wise experienced and reliable organization headed by CCA, itself gave companies with whom the foreign subsidiaries dealt, security as to the reliability of the foreign subsidiaries and thus, undoubtedly gave them a better bargaining position in obtaining financing and customers and brought them business at more advantageous rates and prices than could have been obtained had the foreign subsidiary been attempting to compete all by itself without the technical service agreements and financial backing provided by CCA.

D. ADDITIONAL FACTS SHOW NO DENIAL OF DUE PROCESS

CCA has failed to establish in the evidence (let alone set out in its Statement of the Case) facts which show that California's formula taxes income out of all proportion to CCA's unitary business activities here. On the contrary, the evidence shows that even using the inaccurate[12/] figures used in CCA's argument the average difference between the almost 7% of its worldwide income which it concedes is taxable by California and the income taxed by California here is less

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12. See Appendix C for an analysis of their relevancy and accuracy. The numbers presented by CCA at AB, page 16 improperly use "book" amounts rather than figures actually used for tax purposes.

than .01%.[13/]

CCA has provided no evidence that these slight increases in the income apportioned to California exceeds its allocable share of the substantial benefits provided by CCA to its foreign subsidiaries for which it did not receive . . .

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13. CCA suggests (AB, p. 16) that if only CCA's own activities in the United States, Canada and Puerto Rico are combined, the income which CCA apportions to California is $2.9 million in 1963, $3.1 million in 1964 and $2.9 million in 1965, whereas if the foreign subsidiaries are considered part of the unitary business, California will be permitted to tax $3.1 million in 1963, $3.6 million in 1964 and $3.5 million in 1965. Thus, CCA concedes that California can properly tax a portion of its worldwide income amounting to .0742 in 1963, .0680 in 1964 and .0608 in 1968 of CCA's worldwide net income as reported to the United States government adjusted for California tax purposes. California's worldwide apportionment formula increases these percentages by only .0064 in 1963, .0095 in 1964 and .0119 in 1965. (Computations are based on figures in AB, p. 16; J.A.:Ex p. 7.)

fair market value in return.[14] CCA has proven no distortion.

E. CCA SETS FORTH NO FACTS SUGGESTING VIOLATION OF THE COMMERCE CLAUSE IN ITS STATEMENT OF THE CASE

CCA sets forth no facts in its Statement of the Case which suggest that California's three-factor formula as applied to CCA here, creates double taxation or in any manner violates the Commerce Clause of the United States Constitution. Thus, CCA should be limited under Rule 34.1(g) to the argument that formulary apportionment inherently violates the Commerce Clause, i.e., without regard to any facts.

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14. As is shown by Appendix C, using tax figures, the differences would be even less. Also under Subpart F of the Internal Revenue Code, U.S. income from the foreign subsidiaries was increased by an average of over 2.5 million dollars in 1964 and 1965. (J.A.:Ex, p. 7.)

SUMMARY OF ARGUMENT

CCA argues that the judgment below denying it a refund of taxes should be reversed because the formulary apportionment method by which California calculated the tax violates both the due process and commerce clauses of the United States Constitution.

This appeal is from a determination of the California courts, and accordingly, factual determinations are governed and the factual inquiries on appeal are limited by California procedural law as well as rules of this Court. There is no strong presumption of unity because CCA and its subsidiaries engage in the same type of business. CCA has the burden of proving unconstitutionality by clear and convincing evidence. All facts not clearly stipulated to be true are determined against appellant taxpayer who must prove

not only that the state's method of calculation was improper, but also the proper amount of the tax.

The "linchpin" of formula apportionment is the unitary concept; that where a business is "unitary" formula apportionment may be used; a business is not unitary only when the business activities outside the taxing state are a "discrete" or entirely separate business completely disconnected from the business activities in the taxing state. CCA has failed to establish that its foreign subsidiary activities are not part of its unitary business. CCA provides technical and management expertise, training, machinery and equipment, key personnel, direct loans and loan guarantees, and even some raw materials and sales assistance. Through an international department, CCA oversees the foreign operations and controls their development, budgets and

capital expenditures.

CCA has not proven that these substantial contributions by CCA to the profits of the subsidiaries are reflected in their separate accounting records at fair (or arm's length) value. Some, CCA concedes, cannot be valued at all; some were provided without any charge. This is the precise situation which calls for formula apportionment.

CCA asserts that the formula denies due process by distorting income, because (1) it differs in result from the federal tax measure, (2) there are differences in wage rates and (3) higher return on investment is expected from foreign operations. Due process places the burden on the taxpayer to prove by "clear and cogent evidence" that extraterritorial values are being taxed. CCA's arguments are primarily based upon

its separate accounting approach which clearly apportions insufficient income to U.S.A. Its wage argument ignores the interdependency of all three factors in the formula and is not supported by proper material facts. CCA has not shown that California has taxed a palpably excessive amount of its income, and has shown no due process violation.

CCA asserts Commerce Clause violations based upon Japan Line, Ltd. v. County of Los Angeles (1979) 441 U.S. 434 (hereinafter "Japan Line") discussion of (1) double taxation and (2) need for federal "one voice" in foreign relations. No Commerce Clause violatives are proven.

The Japan Line discussion of double taxation is not applicable to income taxation of a domestic corporation like CCA; nor to apportionment of income of a unitary business. Taxation of the same

income at both state and federal level is proper. Evidence properly before this Court establishes neither actual, nor a substantial risk of constitutionally prohibited double taxation.

The facts properly before this Court do not establish any conflict between California's "combined reporting" of unitary income by formula apportionment and any U.S. government policy on foreign relations. On the contrary, during the period in issue here (1963-1965), all expressed federal policy permitted, and in no way disapproved, use by the states of formula apportionment. Even those who recently have spoken out against use of formula apportionment which includes a totally foreign business whose only contact with U.S.A. is through ownership of an American subsidiary have not objected to formula apportionment where the taxpayer is a domestic American corporation part

of whose unitary enterprise reaches into a foreign country through either a division or a subsidiary. California's tax here interferes with no federal foreign relations.

CCA has not established any due process or commerce clause violations. The judgment should be affirmed.

* * * * *

ARGUMENT

I

CCA HAS THE BURDEN OF ESTABLISHING UNDER CALIFORNIA PROCEDURAL LAW BY CLEAR AND CONVINCING EVIDENCE THAT IT HAS BEEN DEPRIVED OF CONSTITUTIONAL RIGHTS WHICH HAS RESULTED IN OVERPAYMENT OF A SPECIFIC AMOUNT OF TAX

This is an appeal from a decision from the California courts denying refund of taxes as being overpaid. Under California law, CCA as plaintiff in an action for refund has the burden of proof; the absence of evidence on a fact necessarily leads the court to make a factual determination contrary to CCA's position. (See Flying Tiger Line v. State Bd. of Equal. (1958) 157 Cal.App.2d 85, 99; Hall v. Franchise Tax Board (1966) 244 Cal.App.2d 843, 848; Cal. Evid. Code, §§ 500, 550.) In California formulary apportionment carries "the presumption of constitutionality

which attaches to all legislative acts. (El Dorado Oil Works v. McColgan (1950) 34 Cal.2d. 731, 744.) California follows the rule enunciated by the United States Supreme Court that to rebut the presumption that the formula produced a fair result "the burden is on the taxpayer to make oppression manifest by clear, cogent evidence." (Ibid; Norfolk and Western RY Co. v. North Carolina (1936) 297 U.S. 682, 688.) In California a taxpayer must not only show that taxing agency used an improper method of calculation, but also must establish a proper amount of taxes; the taxpayer must show "that more taxes have been exacted than in equity and good conscience and should been paid. (ElDorado Oil Works, supra, p. 744; Pacific Fruit Express Co. v. McColgan (1944) 67 Cal.App. 2d 93, 96.)

Here both the trial court and

the court of appeal in California determined all factual questions in favor of appellee Franchise Tax Board, (sometimes FTB).

The evidence on the question of unity consisted of a "stipulation of facts" which included not only statements of evidentiary fact, but also several exhibits including agreements under which CCA provided services to its foreign subsidiaries, annual reports, a speech, lists of employees, officers and directors serving both CCA and its subsidiaries, portions of tax returns and financial information. This stipulated evidence was in some respects ambiguous, incomplete and subject to contradictory meanings and inferences. Under the foregoing and hereinafter cited authorities, all ambiguitities and inadequacies in the evidence and inferences must be resolved in favor of the appellee taxing authority (FTB).

In its Statement of the Case (AB, p. 2-8) CCA makes no reference to any facts presented before the lower courts on the commerce clause or distortion questions raised below.[15/] This Court's Rule 34.1(g) requires the Statement of the Case contain all that is material to consideration of the questions presented. Accordingly, material omitted from the Statement of the Case may not be asserted by appellant as a basis for reversal, and this Court should refuse to consider any facts urged in support of contentions of distortion in the formula or commerce clause violations.

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15. This evidence consisted mainly of oral testimony of John C.McDonald, (J.A. pp. 118-223), stipulations as to what others would testify. (J.A. pp. 83-117).

A. The Unitary Question Should be Considered On The Basis of the Facts Contained in the Court of Appeal Opinion

This Court does not ordinarily look behind the facts stated in the final state court determination even when a constitutional issue is being reviewed. (See Time, Inc. v. Firestone (1976) 424 U.S. 448, 463; cf. California Liquor Dealers v. Midcal Aluminum (1980) 445 U.S. 111-112.) This Court should not do so here for at least two reasons.

First, as a matter of policy, because of the burden of reviewing the complete evidentiary detail in each case.[16/]

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16. Cases coming through the appellate system (e.g., Firestone v. Franchise Tax Board (CA2 No. 62918) contain records with weeks of testimony and hundreds of multi-paged exhibits. The time consumed by a proper review by the nine judges of this Court of such a record, to determine whether each foreign activity is part of a unitary business, would cripple this

Second, this appeal from the final determination of the Supreme Court of the State of California, must be based on the same facts on which the California Supreme Court based its denial of CCA's Petition for Hearing. Under California Rule of Court No. 29, that decision was based upon the unitary facts set forth in the opinion of the California Court of Appeal. Rule 29, paragraph (b), California Rule of Court provides in part:

> "On petition for hearing the Supreme Court will not examine the record for error unless the petition shows that substantial issues of . . . fact were incorrectly stated . . . in the opinion of the Court of Appeal and that such issues were raised in the briefs and set forth in a petition for

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Fn. 16 (cont'd)
Court's ability to consider other important cases. Furthermore, a decision that the taxpayer was unitary or not unitary during a particular period would have no precedential effect since the operations of businesses vary from year to year.

rehearing in the Court of Appeal."17/ Appellant may not raise issues before this Court which it did not raise before the California Supreme Court. Thus, it is bound here by the same facts on which it presented its petition to the California Supreme, i.e., those set forth in the decision of the California Court of Appeal.

B. If the Record is Reviewed for Evidence of Lack of Unity, All Inadequacies, Ambiguities and Inferences Must Be Resolved Against the Taxpayer-Appellant and All Presumption in Favor of Unity Applied

On appeal the judgment of the lower court is presumed correct. All intendments and presumptions are indulged in favor of the judgment, and error must

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17. While CCA complains to this Court that the Court of Appeal opinion slightly misstated facts in three respects (AB, fn. 1 pp. 2-3), it did not point these alleged errors out on a Petition for Rehearing, and is therefore precluded from asserting them on further appeal.

be affirmatively shown. (Denham v. Superior Court (1970) 2 Cal.3d 557, 564.) The appellate court must accept as true all evidence supporting the findings as well as all inferences which might reasonably have been thought by the trial court to lead to the same conclusion. (Board of Education v. Jack M. (1977) 19 Cal.3d 691, 697.) Where opposing inferences may be reasonably drawn from the facts the trial court's judgment will not be set aside. (McIntyre v. Doe and Roe (1954) 125 Cal.App.2d 285, 287; Mae See v. North American Acc. Ins. Co. (1923) 190 Cal. 421, 426 (even where all the facts are admitted or uncontradicted.))

While California Appellate courts will accept as correct these facts which are stipulated by the parties to be true, where such facts are evidentiary facts and are themselves ambiguous or conflict with other facts stipulated to

be true, all inferences and resolutions of ambiguity must be against the party who has the burden of proof (CCA), especially where (as here) the trial court also made factual determinations against that party. Here where a taxpayer has the burden of establishing its burden by "clear, cogent evidence" (see ElDorado Oil Works, supra, at p. 744; Northfolk and Western RY Co., supra, at p. 688), the need to sustain the validity of California's tax on CCA as a unitary business where that determination is supported by any substantial evidence is even more clear.[18/]

It is believed that this Court has adopted and should continue to apply

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18. One strong policy reason for this rule is that taxpayers uniquely possess and control the records showing their business activities and the witnesses with personal knowledge thereof. Taxpayers are in a position to produce or

the approach that where an imposition of tax by a state is supported by substantial evidence that determination will not be upset. (See General Motors Corp. v. Washington (1964) 377 U.S. 436, 441-442 hg. den. 379 U.S. 875; Norton Co. v. Dept. of Revenue of State of Ill. (1951) 340 U.S. 534, 537-538.)

CCA argues that the tax asserted by California violates the Due Process and Commerce Clauses. In reviewing these arguments the Court's own caveat should be kept in mind:

> "The Constitution is not a formulary. It does not demand of states strict observance of rigid categories nor precision of

Fn. 18 (cont'd)

withhold this evidence at will. Placing any substantial burden upon taxing agencies to discover, obtain and produce admissible evidence from the taxpayer's records and employees would make administration of tax laws as applied to multi-national businesses substantially unenforceable whether determining the existence of unity or of arms length dealing under the federal approach.

> technical phrasing in their exercise of the most basic power of government, that of taxation. For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society." (Wisconsin, v. J.C. Penney Co (1940) 311 U.S. 435, 444.)

The judgment should be affirmed unless CCA can show clearly and convincingly, based on the facts properly before this Court, that it has overpaid its tax (in a specific amount) because of a substantial infringement on a constitutional right. CCA cannot do so. The facts properly before this Court show that CCA's foreign subsidiaries are part of its unitary enterprise; CCA has not shown by its separate accounting, return-on-investment

or other arguments that California has charged an amount of tax grossly disproportionate to the amount of CCA's income producing activity in California; nor has CCA established any overpayment based on the Commerce Clause.

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II

CCA'S FOREIGN SUBSIDIARIES ARE PART OF ITS UNITARY BUSINESS UNDER TESTS APPLIED BY THIS COURT

California's long applied test[19] of a unitary business has been stated by Frank Keesling, "father of the unitary concept":

> "The essential test is whether or not the operation of the portion of the business within the state is dependent upon or contributory to the operation of the business outside the state. If there is such a relationship, the business is unitary. If there is no such relationship, then the business in the state may be considered separate and the income therefrom may be determined without reference to the success or failure of the taxpayer's activities in other states."
> (G. Altman and F. Keesling, Allocation if Income in State Taxation, Commerce Clearing House,

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19. California courts also frequently examine "unities" of "ownership" "operation" and "use" ever since Butler Bros. v. McColgan (1941) 17 Cal.2d 664, 111 Pac.2d 334, affd. (1942) 315 U.S. 501, as was done in this case.

Inc., 2d ed 1950, p. 101.)
(Also see Edison California Stores v. McColgan (1947) 30 Cal.2d 472.) This test was also used by the Wisconsin Supreme Court in Exxon Corp. v. Wisconsin Dept. of Revenue, (1980) 90 Wis.2d 700, affd. 447 U.S. 207.)

The unitary concept as implemented by California consists of two parts -- formula apportionment and the combined report. All states use formula apportionment and some variant of property, payroll and sales to reflect corporate activities. The combined report was first utilized in the Edison California Stores, supra, case, and its basic purpose is to prevent the use of separate corporate entities to influence tax results. It is used by a majority of the states imposing a corporate income tax or franchise tax measured by income. Attached as Appendix D to this

brief is an amicus brief filed in the Illinois Supreme Court in the case of Caterpillar Tractor Co. v. Illinois Department of Revenue, which succinctly explains the operation and rationale of the combined report.

California law as construed by the California courts, mandates formula accounting and the combined report for all taxpayers operating a unitary business within and without California unless it is shown that the out-of-state business is truly separate and distinct from the California business. If the in-state business is dependent upon or contributes to the out-of-state business in any material respect, the businesses cannot be said to be truly separate and distinct. (Honolulu Oil Co. v. Franchise Tax Board (1963) 60 Cal.2d 417; Superior Oil Co. v. Franchise Tax Board, (1963) 60 Cal.2d 406, 386.)

This application of the unitary concept is consistent with its purpose. The existence of such contributions and dependencies evidences a flow of benefits which are not normally reflected in a separate accounting approach. Moreover, the benefits thus transferred are often not susceptible of pecuniary valuation. Indeed, a flow of benefits which defy monetary measurement makes all the more imperative the application of formula apportionment. Only by combining the income of in-state and out-of-state operations can this flow of benefits be properly accounted for. (Harley Treatise, Appen. E hereto.)

A. The Due Process Requirements of Unity Should be No Greater Than California's Contribution Test

This Court has stated that "the linchpin of apportionability in the field of state income taxation is the unitary-

business principle." (Mobil Oil Corp. v. Commissioner of Taxes (1980) 445 U.S. 425.) A taxpayer objecting to formula apportionment must show that the income "was earned in the course of activities unrelated to its activities in the taxing state" and arise from operations that are "distinct" in a business and economic sense which constitutes a "discrete business enterprise." (Ibid.) It would appear that this Court's language in Mobil means the same as California's "contribution" test. Where one part of a business contributes to another part, no "distinct" business exists.

B. Woolworth and ASARCO Reinforce the Rule That an Activity is Part of a Unitary Business Unless it is a Distinct and Discrete Business Which Does Not Benefit the Whole

On June 29, 1982, F. W. Woolworth v. Taxation and Revenue Dept. of New Mexico

50 U.S.L.Week 4957, ___ U.S. ___ (hereinafter "Woolworth"); and ASARCO, Inc. v. Idaho State Tax Commission, 50 U.S.L.Week 4962 ___ U.S. ___ (hereinafter "ASARCO"), were decided by this Court. These decisions dealt with the limited question of the right of a nondomiciliary state to include dividends received from related corporations in the income base subject to apportionment. This issue is not present in CCA; therefore, these decisions are not directly applicable or controlling.[20/] However, this Court chose

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20. Here the property, payroll and sales of the subsidiaries are considered to reduce share of unitary income apportioned to California. Idaho and New Mexico did not include the subsidiaries' property, payroll or sales in their formula, (see dissent in Mobil, 445 U.S. at p. 461-462) and did not apportion the subsidiaries' income, but apportioned only dividends received from subsidiaries which (some suggest) Idaho conceded were not part of ASARCO's unitary business. (Note that Idaho combined [California style] six subsidiaries without any disagreement. See Fn. 8, Opin.) It appears that Idaho and New Mexico thought that the questions

to discuss unity, and finding the subsidiaries to be engaged in entirely separate, discrete, and distinct businesses, refused to permit apportionment of their dividends.

In ASARCO this Court stated:

> "The Mobil Court explicated the limiting 'unitary business' principle by observing that geographic accounting, in purporting to isolate income received in various States, 'may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale.' (Ibid.) The fact that 'these factors of profitability arise from the operation of the business as a whole,' ibid, therefore could justify a State's otherwise impermissible inclusion of corporate income derived from corporate activities beyond the State's borders."
> (ASARCO, Inc., supra, Opin. at p. 9.)

Fn. 20 (cont'd)

in ASARCO and Woolworth were different from whether the subsidiaries whose dividends they apportioned were part of the taxpayer's unitary business.

In Woolworth the court reiterated that it considers the unitary business principle as the "linchpin of apportionability." Then it observed

> " . . . that the potential to operate a company as part of a unitary business is not dispositive when, looking at 'the "underlying economic realities of a unitary business,"' the dividend income from the subsidiardies [sic] in fact is "derived[d] from "unrelated business activity" which constitutes a "discrete business enterprise."' Exxon, 447 U.S. at 223-224, quoting Mobil, 445 U.S., at 441, 442, 439.
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> " . . . . . .
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> "As relevant here, 'the income attributed to [a] State for tax purposes must be rationally related to "values connected with the taxing State." Norfolk & Western R. Co. v. State Tax Comm'n, 390 U.S. 317, 325.' Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978). The state court's reasoning would trivialize this due process limitation by holding it satisfied if the income in question 'adds to the riches of the corporation . . .'
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> " . . . . . .

> "In Mobil we emphasized, as relevant to the right of a State to tax dividends from foreign subsidiaries, the question whether 'contributions to income [of the subsidiaries] result[ed] from functional integration, centralization of management, and economies of scale.' 445 U.S. at 438. If such 'factors of profitability' arising 'from the operation of the business as a whole' exist and evidence the operation of a unitary business, a State can gain a justification for its tax consideration of value that has no other connection with that State. Ibid."
> (F. W. Woolworth Co, supra, Opin. at pp. 7 - 9.)

Thus, a taxpayer who seeks profitability from the business as a whole is operating a unitary business.

The court then observed that "no phase of any subsidiary's business was integrated with the parent's" that there was no centralized training, lending, purchasing, accounting control, etc. and concluded that there was "no functional integration." (Woolworth, supra, at p. 10-11.)

The court also found absence of

centralized management or economies of scale, stating "each subsidiary operated as a distinct business enterprise" without officers who overlapped or came from the parent, without personnel training or exchange to pass Woolworth information to the subsidiaries' operations, no parental participation in selecting store locations, no department overseeing the subsidiaries' operations (Woolworth, supra, at p. 11-13); the court found "no flow of international business." (Id., at p. 16.) The court concluded that the "business activities of the dividend payor had nothing to do with the activities of the recipient." Each of the subsidiaries operated a "discrete business enterprise" with a "notable absence of any umbrella of centralized management and controlled interaction" (Id., at p. 17.), and therefore the dividends were unconnected with the unitary business.

By analyzing Woolworth's activities in terms of "functional integration, centralized management and economies of scale," this Court determined that Woolworth's subsidiaries were separate, discrete businesses. Each was operated by its own management for its own advantage, not for the benefit of the whole. The facts reviewed by this Court suggest no contributions between Woolworth and its subsidiaries for the benefit of the whole, nor contributions to the other which were not accurately reflected under separate accounting.

We submit that the test of unity remains unchanged by Woolworth and ASARCO. Parts of a business which contribute to each other or to the profitability of the whole are unitary; while that activity which is a separate "discrete" business independently operated only for its own benefit and whose dealings (if any exist)

with other commonly owned businesses are handled in an arm's length manner the fair market value of which is accurately reflected in separate accounting records is non-unitary.

C. CCA's Subsidiaries Are Not Discrete Businesses. They Are Part of Its Unitary Enterprise.

Here CCA's foreign subsidiaries (and their incomes) benefit substantially from CCA's contributions of personnel, expertise (both technical and managerial), financing, supplying machinery, equipment and raw materials which are neither accurately nor adequately reflected by CCA's separate accounting. These reflect integration of function, economies of scale, centralization of management and overall operation and internal contributions for the good of the whole. The subsidiaries are part of CCA's unitary business. Formula apportionment is proper.

. . .

(1) Site selection and expansion of markets was centrally controlled.

> "CCA's Management Committee and Board of Directors reviewed and granted approval or disapproval to all suggestions for increased involvement in a present market, acquisition of an unrelated existing concern, or development of a neighboring market for the foreign subsidiary. Initial studies are made by the staff of the relevant subsidiary or CCA's Control Staff, as appropriate. In all cases, review was made by CCA's Senior Vice President for Overseas Operations and possibly other members of corporate staff prior to referral to the Board of Directors. If a subsidiary does not wish to proceed on a project, CCA must decide if it wishes to proceed independently." (J.A. pp. 16-17, ¶ 28.)

(2) International accounting was integrated.

> "CCA's involvement in the development of the subsidiaries' accounting procedures was primarily limited to developing formats for the transfer of necessary information to the United States. CCA needed financial information from the subsidiaries for two reasons: 1) to monitor the performance

of the subsidiaries; and 2) to file the reports mandated by the United States government." (J.A. p. 71, ¶ 136.)

"CCA worked toward achieving the most efficient systems and procedures possible." (J.A. p. 72, ¶ 139.)

(3) CCA centralized and integrated financial planning.

"Monthly financial statements (balance sheet and profit and loss statement) were furnished to CCA. Profits were reported by subsidiary on a monthly basis. In some cases local plant financial reports were furnished to CCA . . . . At the year end more detailed financial statements were furnished to CCA." (J.A. p. 71, ¶ 135.)

"Long range budgeting consisted of a three-year forecast each year of capital projects supported by forecast balance sheets and cash flow statements. The budgets were submitted to CCA. . . . These were usually reviewed by CCA in connection with its annual meeting. Capital projects for each year were reviewed by CCA in connection with its annual meeting. Capital projects for each year were reviewed on a quarterly basis by the Container Management Committee and Board of Directors." (J.A. p. 70, ¶ 134.)

> "If CCA could not determine a subsidiary's condition by merely reviewing its financial statements, it would have been forced to take a more active role." (J.A. p. 71, ¶ 136.)

(4) Auditing was centralized.

> "During the period all international subsidiaries except Holland and Germany were audited by Arthur Andersen & Company as was CCA." (J.A. p. 72, ¶ 138.)

(5) International legal matters were centralized.

> "None of the international subsidiaries used the same legal firms as CCA." (J.A. p. 72, ¶ 138.)

However, the Senior Vice President of Overseas Operations was also CCA's General Counsel. He and another attorney on CCA's "foreign operations staff" each devoted a portion of his time to handling CCA's international legal affairs. (J.A. p. 65, ¶ 126-127.)

(6) Purchasing material was integrated in part.

CCA made sales of linerboard and other paperboard of raw material requirements in small amounts. (J.A. p. 73, ¶ 141; J.A.:Ex. p. 8.) In addition, CCA made purchases of paper for the foreign subsidiaries.[21/] Even small amounts of material purchases from and through CCA in the United States must have been important because the materials are bulky and transportation costs high. (J.A. p. 73, ¶ 142.)

(7) CCA integrated and centralized machinery and equipment acquisition.

CCA sold used equipment to its subsidiaries at depreciated book value. (J.A. p. 76-77, ¶ 147.) It also purchased 90% of the equipment of its Latin American

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21. The purchases for the years before the court are unknown, but averaged in excess of $5,000,000 a year in the next subsequent three years. (JA.p. 74,¶ 143.) This figure, compared to the total Cost of Goods Sold for the foreign subsidiaries, estimated from Exhibits A, 1-8 (J.A.:Ex p. 8) to be no more than $80 million, suggests that CCA purchased six percent or more of the foreign operations Cost of Goods Sold. (See fn. 13 on evaluation of percentages.)

subsidiaries and 10% of the European subsidiaries' equipment. (J.A. p. 77, ¶ 148.)

(8) CCA provided a centralized source of key personnel.

CCA formed most of its subsidiaries and initially provided the personnel to train local laborers as well as manage the business operations. (J.A. pp. 14-15,¶ 25; pp. 41-42,¶ 78.) After the foreign operations had become established, CCA continued to provide personnel (normally key, skilled positions which could not be filled locally. Examples are described supra, pages 19 - 22. (See also Exh. D.)

In providing personnel, CCA would first look within its own organization. (J.A. p. 62, ¶ 120.)

(9) Centralized personnel training at CCA was provided.

Ten to twelve visits a year were made by groups of one to three foreign

employees to CCA for training. These visits lasted two to six weeks. Some were by plant managers. (J.A. p. 69, ¶ 132.)

(10) Key employees and managers were integrated into, and in substance remained employees of, CCA.

Thirty-eight high level American employees of the foreign subsidiaries were carried on CCA's payroll.[22/] They retained most CCA employee benefits; several even received stock options. (See p. 20, supra.)

(11) Centralized financing was provided by CCA.

CCA made substantial direct loans to its foreign subsidiaries, and guaranteed approximately one-third of their borrowings

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22. The total annual cost averaged $380,000, or approximately 2.5 percent of the total foreign payroll. (J.A. p. 60, ¶ 119.) Fifteen of the individuals had plant responsibilities, thirteen had unspecified (but presumably, plant) responsibilities. The total dispersion was eight to Mexico, five to Colombia, nine to Venezuela, four to Germany, and two to Italy. (Exh. C.)

from third parties. (J.A. p. 69-70, ¶ 122.) Thus, in addition to providing equity capital to the subsidiaries, CCA loaned directly or secured by guarantee, over one-half of all amounts borrowed by the subsidiaries.

(12) The paperboard/packaging function was integrated under CCA's control.

CCA and its subsidiaries all engaged in the paperboard/packaging business which consisted primarily of manufacturing paperboard from raw materials (wood pulp, straw, old paper), then manufacturing containers from the paperboard. CCA contracted by Technical Services Agreements to, and did, provide all technical, management and other assistance needed by the subsidiaries to function in that business, (see pp. 12-17 supra; J.A.:Ex pp. 10, 15, 21) and required its approval of any capital expenditure by each subsidiary.

(13) Centralized product design expertise provided economies of scale.

While packaging is normally designed for an individual product, CCA maintained a large design and market research laboratory in the United States (J.A. p. 27, ¶ 56), whose expertise was available to, and used by, subsidiaries. (J.A.:Ex pp. 9-33; J.A. p. 54, ¶ 104.) A central design laboratory in Europe serviced all European operations. (J.A. p. 34, ¶ 66.)

(14) CCA provided sales assistance.

CCA has referred United States customers to its foreign subsidiaries; and in at least one instance, helped negotiate an important contract for a significant new product (J.A. pp. 32-33, 47, ¶¶ 65, 87), even though packaging is not sold to the public and marketing by subsidiaries is apparently a minor function. (See pp. 29-30, supra.)

(15) CCA centrally managed its overseas operations just like it centrally managed its United States operations.

As is pointed out by the California court below (and pp. 6-7 supra), CCA operated its concededly unitary U.S.A. business in the same way it did its foreign subsidiaries--as a diversified business under substantially autonomous officers (regional vice presidents) who made the day-to-day operational decisions. When distances between business facilities become substantial, centralized operation of day-to day activities becomes difficult and inefficient. In both Butler Brothers and Exxon the operational departments were treated as independent profit centers. Yet this Court found each to be unitary businesses because of "benefits from an umbrella of centralized management and controlled interaction." (Exxon, supra, 447 U.S. at p. 224.)

Like an umbrella which is always available to help, but only used when it rains, centralized management and controlled interaction need not be "hands on" day-to-day control, but only a controlling higher management authority which knows what is generally going on and can be (and is when needed) used to see that the subsidiary operates for the good of the business enterprise as a whole.

While centralized control of day-to-day decisions may show that a business is unitary, it is not a prerequisite to "unity" for tax purposes. Centralized decisions by upper management to benefit the business as a whole suggest a unitary enterprise.

Substantial evidence of this unitary management goal of benefiting CCA's worldwide operations as a whole is present.

a) CCA publically holds itself out as a single integrated worldwide business. (See Exh. H, pp. 5-6 - Speech by CCA President; Exh. I - Annual Reports.)

b) A number of directors and officers serve both CCA and one or more subsidiaries at the same time. (Exh. E.)

c) CCA's Overseas Department centralizes the management of the foreign subsidiary operations. CCA has a foreign operations staff which includes three vice presidents, an attorney and a controller. (J.A. p. 65, ¶ 126.) One vice president for Latin America, and another of European operations spend full time in Latin America and Europe respectively. The Senior Vice President, stationed in U.S.A., travels to each subsidiary once or twice a year. His function is to "oversee CCA's foreign subsidiaries and communicate requirements for compliance with CCA's standards for

professionalism, profitability and ethical practices. (J.A. p. 66, ¶ 127.) Through the Overseas Department, current and three-year projected budgets and proposals for expansions and capital purchases by the subsidiaries are presented to CCA management.

(16) A centralized insurance agent is used.

Since 1967, CCA and all its subsidiaries use the same insurance agent. Earlier this centralization had not been extended to Europe. (J.A. p. 78, ¶ 149.)

The importance of centralized management, functional integration and economies of scale are as evidence of a "unitary" business' goal to work together toward maximizing <u>overall</u> profits, rather than each subsidiary being operated to maximize <u>its own</u> profits regardless of the effect on other CCA departments and subsidiaries.

In Exxon this Court referred to a centralized purchasing department "whose obvious purpose was to increase over-all corporate profits." (Id., at p. 224.) Further evidence of CCA's unitary operation is the fact that within each foreign country, several CCA subsidiaries operate as "an integrated unit" and not in competition with each other. (J.A. p. 31, ¶ 63.)

The fact that CCA did not require payment of fair market value for goods and services passing between it and its subsidiaries, (see pp. 32-35, supra) is not only further evidence of its intention that its business be operated as a unitary enterprise for the good of the whole, but also establishes the inaccuracy and inadequacy of its separate accounting as a method of apportioning income for tax purposes.

CCA has conceded that the fair value of some of the services it provides

to its subsidiaries cannot be determined. (J.A. p. 75, ¶ 144.) The sole use of the unitary concept is to support use of formula apportionment rather than separate accounting to apportion net income for tax purposes. Therefore, the inability to to segregate expenses by separate accounting should be considered strong support for use of formula apportionment.

California law creates a presumption that all operations under the same control in the same line of business are unitary. (See J.S. pp. A-16, A-17.) California places the burden of proof on the taxpayer to show its activities are not unitary. Both rules are proper and applicable here. In addition, the record clearly shows that the subsidiaries are not separate, "discrete" businesses each operated for its own separate goals. The Court of Appeal's determination that CCA's

foreign subsidiaries are each part of CCA's unitary enterprise should be affirmed.

D. Intercompany Product Flow Is not a Prerequisite to The Existence of a Unitary Business.

CCA argues that a large flow of goods is a prerequisite to a unitary business.

In the earliest cases considered by this Court, Underwood Typewriter Co. v. Chamberlain (1920) 254 U.S. 113 and Bass, Ratcliff & Gretton Ltd v. Tax Comm. (1924) 266 U.S. 271 there was manufacturing in one state with sales in another. Product flow existed in that one arm of the business manufactured a product and transferred it to another arm located in another state for sale. Appellant argues that this product flow is a prerequisite to a finding of unity. (AB pp. 40-49.)

Appellant's argument ignores subsequent decisions of this Court such

as Butler, Bros., supra. In that case there was central purchasing but no actual product flow. The court stated, " the operation of the central buying division along demonstrates that functionally the various branches are closely integrated." (315 U.S. at p. 508.)

As pointed out in the discussion in this Court's recent decision in Exxon Corp. v. Wisconsin, supra, centralized purchasing (or inter-company product flow) is only one indicia of a "highly integrated business which benefits from an umbrella of centralized management and controlled interaction." What the court's decisions say is that if this tie exists, no further inquiries are necessary. It does not say as CCA claims that if the tie does not exist, then a business can not be unitary.

Appellant doubtless would argue that Butler Bros. did involve product flow,

but then what of Exxon? In that case the court found that, "[e]ven the gasoline sold in Wisconsin was available only because of an exchange agreement with another company . . . ." (447 U.S. at p. 224.) None of Exxon's production was utilized to produce the gasoline sold in Wisconsin.

Treating CCA's foreign operations as a separate and discrete business would fail to reflect the contribution made to any by them to the overall business "through functional integration, centralization ization of management, and economies of scale. (Mobil Oil Corp., supra,445 U.S. at p. 438.) Since such factors arise "from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation, it is not

constitutionally required." (Ibid.)

A state may

> " . . . take into account property situated elsewhere when it can be seen in some plain and fairly intelligible way that it adds to the value of the [property] and the rights exercised in the State.' This is directly applicable to to the carrying on of a unitary business of manufacture and sale partly within and partly without the State."
> (Bass, Ratcliff etc., supra, 266 U.S. at p. 232.)

The California Supreme Court clearly rejected product flow as a prerequisite of unity in Honolulu Oil Corp. v. Franchise Tax Bd., supra, 60 Cal.2d 417 and Superior Oil Co. v. Franchise Tax Board, supra, 60 Cal.2d 406. Many other examples of unitary business could be described where all parts contribute to the profit of the whole, and separate accounting cannot accurately apportion income, but there is no flow of goods.

While a state could choose (for facility of administration) to limit its use of formula apportionment to cases of large product flow, due process places no such limitation.

E. Income of Foreign Subsidiaries Which Are Part of a Unitary Business May Be Combined Without Violating Due Process

The argument that combined reporting denies due process when applied to unitary foreign subsidiaries of a domestic taxpayer has been rejected by this court in Mobil, supra, 445 U.S. 425.

> "The argument that the [foreign] source of the income precludes its taxability runs contrary to precedent. . . . Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required.
>
> "The Court has applied the same rationale to businesses operating both here and abroad. Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n, 266 U.S. 271 (1924) is the leading example." (Id., at p. 438.)

> "Superficially, inter-corporate division might appear to be a more attractive basis for limiting apportionability. But the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise. Had appellant chosen to operate its foreign subsidiaries as separate divisions of a legally as well as a functionally integrated enterprise, there is little doubt that the income derived from these divisions would meet due process requirements for apportionability. Cf. General Motors Corp. v. Washington (1964) 377 U.S. 436. Transforming the same income into dividends from legally separate entities works no change in the underlying economic realities of a unitary business, and accordingly it ought not to affect the apportionability of income the parent receives." (Mobil at pp. 440 441.)

Thus, it should be clear that California is not prevented from using formula apportionment merely because the unitary enterprise includes foreign subsidiaries. The sole remaining due process question then becomes whether the

formula "led to a grossly distorted result" by allowing taxation by California of an amount of income "out of all appropriate proportion to the business transacted" there. (Exxon, supra, 447 U.S. at p. 83.) Is the amount of income taxed by California "fairly related to the services provided by the state." (Id., at p. 84.)

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